Supreme Court, U.S.
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No. 99-417

IN THE

# Supreme Court of the United States

LAWRENCE EPSTEIN, *et al.*,

*Petitioners,*

*v.*

MATSUSHITA ELECTRIC INDUSTRIAL CO., LTD. and MATSUSHITA HOLDING CORPORATION,

*Respondents.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

## REPLY BRIEF FOR PETITIONERS

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## MISCELLANEOUS

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## INTRODUCTION

This petition raises important questions concerning the conditions necessary for a class action judgment to have preclusive effect on absent class members. Respondents silently concede that the legal positions they espouse directly conflict with those advanced by three members of this Court in *Matsushita*, 516 U.S. 367 at 395 (1996) *et seq.*, as well as the Restatement (Second) of Judgments, *id.* at 396, and the leading treatises.[1] This case, accordingly, provides an ideal vehicle for this Court to resolve the issues raised because respondents' opposition also shows that there is *no* material factual dispute.

*First.* Respondents do not deny -- not even faintly -- that all four federal circuit judges who examined the record found inadequate representation, using such terms as "hostile," "subversive]" and "collusion". Nor do respondents challenge Judge Wiggins' statement that the evidence of inadequate representation was "*convincing[].*" App. 20a. Nor do they deny that the Delaware court said that "suspicions [of collusion] abound" and then *incorrectly* put the burden of proof "on collusion" on the objectors. Pet. at 18-19.

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[1] In a lengthy and approving analysis of Judge Norris' opinion, now withdrawn, at 18 Wright, Miller & Cooper, Federal Practice and Procedure § 4455 (1999 Supp.), the authors assert "it has long been the general understanding . . . that only adequate representation can justify preclusion against absent class members. . . . The Ninth circuit opinion is a strong statement of the traditional view." Respondents reinterpret the federal decisions, Pet. at 12-14, to focus solely on notice. Resp. Br. at 12-13. And they ignore the explicit holding of the Delaware Supreme Court in *Prezant v. DeAngelis.*

Respondents *necessarily* contend, therefore, that a class action judgment is binding *despite inadequate representation* in fact.

*Second.* Respondents concede (Resp. Br. at 10-11 n.4) that in the Delaware proceeding there was no inquiry whatsoever into the Delaware plaintiffs' membership in the class, and their capacity to represent it, let alone whether they had represented it adequately. Respondents state that the complaint alleged the Delaware plaintiffs were owners of stock "and this contention was uncontested" (Resp. Br. at 11 n.4). The complaint was unverified,[2] and respondents' statement simply confirms Judge Thomas's analysis (App. 22a) that there was *no* record *evidence* of any kind that the named plaintiffs were even members of the settling class. *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 625-26 (1997) ("a class representative must be part of the class"). Moreover, respondents do not deny that, when they sought certification as class representatives, any federal claims they held were time barred, as Judge Thomas observed. App. 25a; Pet. at 17. To allow plaintiffs whose own claims are time barred to represent classes is in direct conflict with federal case law. *E.g.*, *Great Rivers Cooperative of SE Iowa v.*

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[2] Respondent Appendix 47a. Even if the allegations of ownership (made on information and belief alone) were true, plaintiffs' allegations are insufficient to make them members of the subclass of Delaware plaintiffs who once had federal claims. They did not allege that they *tendered* their shares. There must be a purchase or sale of securities to trigger federal rights under the Exchange Act. Moreover, the complaint did not contain even a formal allegation that plaintiffs would adequately represent the class.

*Farmlands Industries, Inc.*, 120 F.3d 893, 899 (8th Cir. 1997); Pet. at 17.

Respondents *necessarily* contend, therefore, that a class constituted at a fairness hearing simply on the basis of an oral argument, without evidence, and with no litigant with viable claims before the court, can give rise to a valid class judgment if no one objects.

Respondents' fundamental position -- that there can be *no* challenge to a class action judgment in any court, so long as that court has Rule 23 or its functional equivalent, and the court makes a journal recital of adequate representation (Resp. Br. at 10 n.3) wholly eliminates any "due process check" (Ginsburg, J., 516 U.S. at 389) on class action judgments. This means that, contrary to the settled law, 516 U.S. at 395 (Ginsburg, J.), the class action court *can* conclusively determine the *res judicata* effect of its own judgment so long as it simply recites that "adequate representation" existed.

At the same time, as they transform the "due process check" into whether the class action court purported to employ certain procedures, respondents and the Ninth Circuit do not extend the necessary procedures beyond the bare text of Rule 23. Thus, for them, it is irrelevant that the class notice did not list adequacy of representation as an issue (App. 28a), nor did the judgment initially submitted by the settling parties include a finding with respect to it; that the complaint was unverified and, in any event, did not show that anyone was constitutionally competent to surrender the federal claims; that that while "suspicions [of collusion] abound" the vice chancellor *incorrectly* placed the burden of proof upon the objectors. For respondents, a perfunctory

recital of adequate representation in a judgment submitted by the litigants is sufficient to bind absent class members, whatever the actual status of the proceedings.

This Court's guidance is imperatively needed. This Court should not permit well understood class action principles to be thrown into confusion. This is a case in which there is convincing and unrebutted evidence of inadequate representation. This case provides an ideal vehicle for this Court to emphasize the importance of the requirement that adequate representation must exist "at all times" if a class action judgment is to bind absent class members. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 812 (1985); *Ortiz v. Fibreboard Corp.*, 119 S.Ct. 2295, 2315 n.24 (1999). Rigorous insistence upon this requirement is indispensable to the very legitimacy of the class action mechanism. In a world of multiple class actions, insistence upon this requirement is especially vital if the defendant is to be prevented from simply "auctioning off" a settlement to the lowest "bidder."[3]

## I. RESPONDENTS' CLAIMS CONFLICT WITH ESTABLISHED LAW.

Respondents press a wide range of claims in the hope of deflecting attention from their concessions.

A. Adopting the position of the panel majority below, respondents insist (p. 9) that "a federal court is to consider only whether the state court *procedures* are adequate

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[3] This has been aptly described as a "reverse auction", because defendants, in effect, sell to the lowest bidder. John C. Coffee, Jr., *Class Wars*: The Dilemma of the Mass Tort Class Action, 95 Colum. L. Rev. 1343, 1354 (1995).

to ensure that the parties have a full and fair opportunity to litigate their claims; . . ."

(i) We have examined this argument at length. Pet. at 11-15. Adequate representation does not mean just adequate procedures. If a class member is to be bound by representation, his representative must *actually* represent the class member "at all times", not just, as respondents claim, only at the point at which the class representative examines the forum's procedures. As Judge Norris said, citing *Hansberry*, "No procedure can reliably protect an absent plaintiff who does not *in fact* have an adequate representative in court championing his cause." App. 56a. Adequate representation "at all times" is a condition indispensable to the legitimacy of the class action. A contrary rule is license for fraud, as Judge Thomas observed, and will have especially deleterious result in the now familiar context of competing class actions. As we have said (p. 1), respondents *silently concede that their legal position is directly in conflict with the views expressed by three members of this Court as well as the Restatement (Second) of Judgements*. Respondents cite no authority for their proposed rule, and then simply ignore *Shutts*' statement that adequate representation must exist "at all times". [4] That duty is a "continuing one," as Justice

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[4] Respondents sometimes suggest that the right to opt out is a due process solvent (pp. 14-15 n.7). This is inconsistent with *Shutts*, a case in which that right existed. It is also inconsistent with Delaware law. *Prezant v. De Angelis*, 636 A.2d 915, 924 n.6 (1994), rejects the scattered line of authority upon which respondents rely. As Wright, Miller and Cooper observe, "Actual notice, the opportunity to opt-out – when it is afforded, the opportunity to appear and participate, and the opportunity to object

Ginsburg said. 516 U.S. at 395.

(ii) However, even on respondent "procedures only" approach, the Delaware proceedings were "fundamentally flawed". As we note (p. 1), respondents concede that no inquiry ever was made into the capacity of the named plaintiffs to represent the class. A class cannot be constituted on the basis of allegations, Pet. at 16-17 n.10, and most assuredly not only on the basis of oral argument. To bind, *the record must contain record evidence of some kind* on that issue. *Prezant, supra*, 636 A.2d at 924, squarely so holds; *see also* 516 U.S. at 397 (Ginsburg, J.). Moreover, the Delaware court put the burden on the wrong party, the objectors, and the wrong burden at that: actual collusion rather than simply inadequate representation.[5] The Delaware proceedings were, accordingly, "fundamentally flawed".

B. Unwilling in the end to rely upon the Ninth Circuit's analysis, respondents also insist that the issue of adequacy of representation was "fully and fairly litigated" in Delaware, and that binds absent class members. Resp. Br. at 8. As a factual matter, that claim is without record support. As Judge Thomas noted, the term adequate representation was

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to settlement, are opportunities. They are not obligations." 18 *Federal Practice and Procedure* § 4455 (1999 Supp.)

[5] In the process the vice chancellor ignored the fact that inadequate representation is not the same as collusion. As Judge Thomas noted, "The fact that there was no finding of wrongdoing certainly does not preclude a finding that the federal plaintiffs were inadequately represented by the settling class." App. 29a. And the vice chancellor compounded his error by placing the burden of proof on the objectors. In this Court, respondents conceded at oral argument that the burden was on them. App. 111a.

mentioned only once in the entirety of the Delaware proceeding, and then only in the context of an affidavit urging the vice chancellor to beware of the settlement proposed by the Delaware plaintiffs who had previously shown themselves to have been inadequate in the first settlement rejection. App. 43a. Many critical arguments bearing upon inadequate representation -- such as the richly documented Delaware class counsel's numerous misrepresentations as to the content of federal securities law and the status of federal proceeding (App. 26a, 69a, 80a) and the constitutional requirement that the class representations have *some* litigable claims -- were never mentioned at all. If litigation can be "full and fair" in such circumstances, this Court's guidance is needed on that concept too.[6]

More fundamentally, the conduct of the Delaware objectors could not conclusively bind absent class members. As Judge Norris said, "Objectors are objectors, not class representatives." App. 45a, 47a. No Delaware statute authorizes objectors to act on behalf of the class[7]; nor were

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[6] Respondents' efforts to treat petitioners as "present" through a surrogate in Delaware is one they have urged throughout this lengthy litigation. No judge has given it credence, because the evidence is indisputable that petitioners neither solicited, financed, nor controlled any of the objectors. *Montana v. United States*, 440 U.S. 147 (1979). In particular, objector Krupman's counsel submitted his own work for his own client.

[7] For that reason, the manner and scope of the objectors' participation is completely within the control of the judge. Patrick Woolley, *Rethinking the Adequacy of Adequate Representation*, 75 Texas L. Rev. 571, 580-81 (1997) (noting absent class members' limited right to participate).

they authorized by the class to do so, as Judge Thomas observed. App. 30a. And there is no evidence that they voluntarily undertook the heavy fiduciary duties and responsibilities associated with class representation.[8] As the First Circuit recently noted in rejecting a claim by objectors, objectors do not owe fiduciary duties to the class. Only class representatives do. *Duhaime v. John Hancock Mutual Life Ins. Co.*, 183 F.3d 1, 5 (1999).

## II. THIS CASE DOES NOT INVOLVE OPEN ENDED CHALLENGES

Respondents seek to portray petitioners as contemplating open ended challenges to class action settlements. This is clearly wrong. This is *not* a case where the federal court was called upon to engage in open-ended, free-wheeling, second-guessing of the judgment of the class action court on the quality of representation by class counsel. Far from it. The Delaware court never addressed that issue, except to say that "suspicions [of collusion] abound"; this is a case where all four circuit judges concluded that representation by class counsel was, beyond contradiction, inadequate representation, and it is a case in which, as Judge Wiggins observed where there was "*convincing[]*" evidence of inadequate, indeed "*hostile*" representation. App. 20a. Due process precludes full faith and credit for such a judgment.

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[8] Judge Thomas quite properly characterized the Delaware objectors as "inadequate." App. 31a.

## III. THIS COURT LEFT OPEN WHETHER THE DELAWARE JUDGMENT VIOLATED DUE PROCESS

Respondents insist that the panel majority was simply "implementing" this Court's decision in *Matsushita*, and that this Court necessarily decided that the Delaware judgment satisfied due process. In that process, they do not even mention footnote 5's express reservation of the issue, or the numerous decisions of this Court (Pet. at 20 n.13) relying upon that "we do not decide" language.[9] We have addressed this issue in detail. Pet. at 19-22. We simply note here that footnote 5 is not a "hint" to the lower courts to substitute impressionism for doctrinal analysis in treating issues the Court has explicitly reserved. Footnote 5 is, as we have said (Pet. at 20) a holding of the Court, one that was necessary for its full disposition of the appeal. As we point out (Pet. at

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[9] Respondents' reference (p. 5) to the Court's statement that "we think a Delaware court would afford preclusive effect to the settlement judgment in this case" refers to a very different issue: the scope of Delaware preclusion law on "global" settlements. This Court believed that Delaware applied a "same transaction" test, not the narrower "operative fact" test to measure the state court's right to release federal claims. Justice Ginsburg, on this issue joined by Justice Stevens but not Justice Souter, dissented from the Court's "endeavor to forecast Delaware preclusion law." 516 U.S. at 394 n.4. Commentators clearly understood that the Court's references were to the content of Delaware preclusion law. *Exclusive Federal Jurisdiction*, 110 Harv. L. Rev. 297, 303-305 (1996), and that adequacy of representation was open on remand, *id.* at 302, 307 n.79 ("The lower [federal] courts will have the final say and most likely will withhold preclusion because of the glaring due process inadequacies").

19-20) this Court must retain for itself alone the authority to decide what it has and has not decided if it is to fulfill its institutional role in the American legal system.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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